CORPORATE VOTING AND PUBLIC POLICY.

WE often find sweeping expressions in the decisions to the effect that in private corporations the right of suffrage cannot be lawfully disassociated from the ownership of the shares, and that one cannot lawfully hold the shares and another lawfully exercise the right of suffrage that pertains to said shares. The shareholder is said to have a duty to fulfil towards his co-shareholders and to the State which conferred upon him a franchise *for the benefit of the public.* This duty is declared to require him to express his own voice and exercise his own reason in the management of the affairs of the corporation. It is not intended to deny the right, now generally conceded by statute, to permit another to vote by proxy from the owner of the shares, but to insist that no agreement can be made, or proxy given, which shall be irrevocable or binding upon the owner of the shares.

In Woodruff *v.* Dubuque and S. C. R. Co.,[1] it is said (*obiter*) that the right to control the vote upon shares "*apparently* cannot be granted away separately from its ownership." In Griffith *v.* Jewett,[2] where shares were assigned to trustees with an irrevocable power to vote thereon, the trustees issuing in lieu thereof negotiable certificates, the Superior Court of Cincinnati, on motion of one of these stockholders, enjoined the trustees from voting on his particular stock, and said that under the conditions of such a trust, "the party holding the entire beneficial interest in the stock cannot cast the vote thereof, while it may be voted by one having no interest in it, or in the Company: and so it may come to pass that the ownership of a majority of the stock of a Company may be vested in one set of persons, and the control of the Company irrevocably vested in others. It seems clear that such a state of affairs would be intolerable and is not contemplated by the law; the universal policy of which is that the control of stock companies shall be and remain with the holders of the stock. The right to vote is an incident of the ownership of stock, and cannot exist apart from it." The same Court refused a similar application for this injunction, made by a stockholder, whose shares were not in question.[3] In

[1] 30 Fed. Rep. 91, 93.

[2] 15 Wk. L. B. 419.

[3] Zimmerman *v.* Jewett, 19 Abb. N. C. 459.

Hafer *v.* N. Y. Co.,[1] where the purpose of the "trust" was to work out a scheme, illegal in itself, the Court said: "The law has confided the care of the franchises and property of this Company to the stockholders, and it is the duty of each stockholder to vote for directors of the Company with an eye singly to its best interests. . . . A sale by a stockholder of the power to vote upon his shares is illegal for very much the same reason that a sale of his vote by a citizen at the polls, or by a director of a corporation at a meeting of the Board, is illegal. Each is a violation of duty; in effect, if not in purpose, a betrayal of trust." In Ohio R. Co. *v.* State,[2] an agreement providing for the voting of shares by trustees as stockholders of record, in accordance with the previous instructions of a Committee of Stockholders, whose instructions were to be determined by a vote of the majority of the Committee, it was said that "such an agreement differs widely from agreements whereby the stock is placed in the hands of trustees who are invested with the power of voting it as their interests may dictate, irrespective of the wishes or direction of the owners. Such an agreement as the latter would be void as against the policy of our corporation law." In Moses *v.* Scott,[3] where the Court was asked to enforce an agreement, void as an unlawful restraint upon alienation, it was said: "Whether an agreement to vote as a unit, or as an agreed majority may dictate for any given length of time, is a contract so binding in its terms that no party to it can withdraw from it or disregard it without the consent of his fellows, may be a very different question. Possibly public policy may exert an influence in the solution of this problem; and even if such a contract be lawful, and on its face exert a continuing force, the grave question comes up, will a Court of Chancery, in its enlightened discretion, lend its aid to the enforcement of a contract of so doubtful policy?"

In Gage *v.* Fisher,[4] it was attempted to enforce a voting agreement, the consideration for which was the promise of an office in the corporation. The Court said: "Here a contract was to give a minority stockholder the right to dominate and direct the judgment of the plaintiff as stockholder in the voting of his stock, without owning the stock himself. Every other stockholder had the right to demand that the plaintiff should, if he desired to do so, ex-

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[1] 14 Wk. L. B. 70.

[2] 49 Ohio St. 668.

[3] 84 Ala. 608.

[4] 1 N. Dak. 813.

ercise at the very time of the annual meeting his own judgment as to the best interests of all the stockholders, untrammelled by dictation and unfettered by the obligation of any contract. We know of no case where equity has enforced such an agreement." In Harvey *v.* Linville Imp. Co.,[1] the Court said that all agreements and devices by which stockholders surrender their voting powers are invalid. "The power to vote is inherently annexed to and inseparable from the real ownership of each share, and can only be delegated by proxy with power of revocation. The pooling arrangement admitted to have been entered into by the majority of stockholders in the present case, is contrary to public policy and void." Greenhood on Public Policy, page 502, says: "Any contract by which the owner of corporate stock deprives himself of the important rights which accrue from such ownership, is void," although he seems to state it the other way in his Rule 544. Cook on Stockholders, Sect. 610, says: "A proxy is always revocable. Even when by its terms it is made irrevocable, the law allows the stockholder to revoke it. Frequently an attempt is made to permanently unite the voting power of several stockholders, and thus control the corporation by giving irrevocable proxies to specified persons. But the law allows the stockholder to revoke the proxy at any time." A similar doctrine is contended for by Professor Baldwin in the first article of Volume I of the Yale Law Review.

It will be found upon investigation that the language used in practically all of these decisions is much broader than was called for by the facts involved in them, and therefore is open to the usual objection that it probably was not considered to the extent to which it goes. And neither Greenhood nor Cook cites any cases that on their facts sustain the doctrine as stated by them. But the language used is sufficiently positive to justify an inquiry as to that principle of public policy which the Courts had in mind and which is said to be violated by agreements separating the right to vote on shares from their so-called ownership. It should be remembered at the outset that corporation law is still in the development stage, but it will be seen that this development is all in the direction to make this doctrine, without proper qualification, illogical and untenable.

How, then, do these agreements injuriously affect the welfare of the public? Public policy is a vague principle at best, and except

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[1] 24 S. E. Rep. 489 (N. C.).

as we follow the beaten path, an uncertain and therefore dangerous one to follow. Agreements void as against public policy are generally classified as those, *a*, founded upon corrupt considerations or moral turpitude: *b*, in violation of a public trust; *c*, in restraint of trade or marriage; *d*, to influence persons in authority. The law really recognizes only two kinds of wrongs: those that are inherently so, — that is, speaking popularly, morally wrong; and those that are wrong because prohibited. There clearly is no moral wrong in the making, but only in the violation of an agreement, made without any corrupt motive for the voting of shares. It must be asked, therefore, of what express law the agreement violates the policy. What principle of express corporation law is infringed by such agreement? The ground of objection is stated to be that the voting power ought not to be confided to persons having no interest in the welfare of the corporation. But as to this certainly, it may be urged at the outset, that in at least one instance, the existing corporation statutes recognize a different policy. In almost every State, where general corporation statutes have been enacted, it is provided that no person shall vote at a meeting who has not held shares in his name upon the books of the corporation, for a certain number of days prior to the election. Sometimes the transfer books are required to be closed at some time prior to the election. If, under such a law, a stockholder should sell his shares and indorse his certificates and receive the purchase price within those intervening days, he would cease to have any beneficial interest whatever in the shares, or in the corporation, and yet he would be entitled to vote. It was expressly so decided in People *v.* Robinson.[1] And if the purchaser of those shares were to secure, as part of the consideration for the payment of the purchase price, a proxy to vote upon the shares, would the transaction be illegal or immoral, or would the proxy be revocable?

So, too, general corporation laws almost universally provide that all transfers of shares, not registered upon the books of the corporation, shall be void except between the parties thereto. Under this provision, can the corporation or other stockholders successfully challenge the vote of the transferrer, whose name appears on the books of the corporation as the registered owner, because of the fact that he has no beneficial ownership in the corporation?

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[1] 64 Cal. 373.

It might perhaps be said more plausibly, that at the time when voting by proxy was prohibited, the making of an agreement by which the owner of shares parted with the right to vote upon them, would have been against the policy of express corporation law. It is universally conceded that in the absence of statute, a proxy to vote upon shares is void.[1] But this rule of the common law has been abrogated practically everywhere, and we find the change occurring at the time when general laws are enacted providing, as a matter of common right, for the obtaining of charters, upon the perfunctory execution of simple declarations and the payment of nominal fees. In other words, it might be well said, that at a time when charters are granted as a matter of personal favor, and because of the special confidence reposed by the State in its trusted subjects, one of the privileges connected with the incorporation of companies being the ownership of shares and the right to vote thereon, that that and all other rights granted by the Charter should be restricted to those in whom the special confidence had been reposed. But if the reason for the rule contended for be that the stockholder, because of the special confidence reposed in him, has received a franchise from the State, in which the public has an interest, and that he therefore virtually receives and must hold and use his stock, as a public trust, that cannot any longer be the rule because the reason itself has ceased. Corporate franchises are now rarely acquired by special grant from the State. Any persons (with certain unimportant qualifications), however unworthy, may by their own action form a corporation, and may immediately transfer the corporate franchise to other persons, even more unworthy. The State has no voice in the matter; there is no *delectus personarum*. The right to incorporate is statutory, "free to everybody. The rights in the corporation can be adjusted by contract and the terms fixed by contract. The corporation is little more under our laws than a joint-stock company under the English laws; indeed, in its true nature, more nearly resembling a limited partnership, under special articles, than a corporation at common law."[2] When the policy of the State changes to the point that the obtaining of charters is a matter of universal right, the restriction upon the personnel of the voter should be removed. And when, as now, the right to vote by proxy has become established, so that a

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[1] Thompson on Corporations, sec. 736.

[2] Chater *v.* Sugar Refinery Co., 19 Cal. 245; see N. E. Trust Co. *v.* Abbott, 162 Mass. 148.

stockholder may delegate by proxy, *without consideration* and to one who has no interest in the shares, or in the corporation, the *revocable* right to vote, why can he not, for a valuable consideration and for an honest purpose, give that right to another irrevocably? It is to be noted, in this connection, that at least one very respectable Court has gone so far as to decide that an agreement between stockholders *not* to vote by proxy is itself pernicious and void as against public policy.[1] Not alone then, according to this authority, is this duty not one that the trustee must perform himself (*delegatus non potest delegare* to the contrary notwithstanding) but he cannot even by agreement deprive himself of the power to disassociate the right of suffrage.

The purpose of voting agreements is generally to control the election of directors.

It is conceded to be the general rule, sanctioned by the policy of the law, that those who have the largest interest in corporations may combine to control them, even by preliminary concert and agreement, as they have the greatest interest that they should be well managed.[2] And it is admitted that neither a minority stockholder, nor the corporation, nor the State, can complain of an agreement by the stockholder giving to another the right to vote, the contention going substantially no further than to insist upon the right of the shareholder to withdraw at any time from such agreement.[3] But it should make no difference in principle whether a majority of stock is held by a single individual, or by a number of them acting in common, or through selected representatives; or whether the representatives be selected through the medium of a power of attorney or an agreement. Again, it will be admitted that the ownership of shares represents a double right, — the right to vote and the right to participate in profits. If it be lawful to sell an interest in the latter right, as it undoubtedly is, why not then, in the former? From that point of view, the party accorded the right to vote becomes a part owner of the shares, and there is no longer a disassociation of ownership from voting power, but only of voting power from the right to dividends. This would therefore seem to be the better doctrine, and one with which probably no case, upon its exact facts, is in conflict.

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[1] Fisher *v.* Bush, 35 Hun, 641.

[2] See Barnes *v.* Brown, 80 N. Y. 547, and Havemeyer *v.* Havemeyer, 43 N. Y. Super. Ct. 506.

[3] Griffith *v.* Jewett, *supra.*

The question always should be, has the agreement been made upon a sufficient consideration, and for an honest, as distinguished from a corrupt, purpose? In Brown *v.* Pacific S. S. Co.[1] the provisions of the agreement under consideration were substantially that the parties to it were not to sell their stock without having first offered to sell it to the rest of their associates at a price not above the then current market value, and, in case of their declining to take it, without next offering it to certain bankers. The agreement took the shape of an irrevocable power of attorney to these bankers to vote upon the stock. In answer to the objection that the agreement was against public policy, and void, Judge Blatchford said: "The agreement seems to differ very little from a mere power of attorney or proxy to Brown Brothers & Company to vote upon these shares, with the addition that the power is irrevocable, and that there are certain privileges reserved to the owners of the stock in regard to the manner of dealing in it and withdrawing from the arrangement. I am unable to perceive anything in this contrary to public policy, or anywise open to objection." In Faulds *v.* Yates,[2] where three shareholders agreed to vest in a third person for a certain time the right to vote all the shares owned by them in severalty, but together representing a control of the corporation, and the validity of the agreement was in question, it was said that "there was no fraud in the agreement; there was nothing unlawful in it; there was nothing which necessarily affected the rights and interests of the minority. . . . If this combination was fraudulent and intended for bad purposes, the stockholders who are in a minority, and who may have suffered, have ample redress."

In Mobile & Ohio Co. *v.* Nicholas,[3] where there was involved the validity of an agreement for the reorganization of a railroad company, by which, for a certain time, the stockholders vested in a trustee an irrevocable power to vote the stock, the Court said: "We have examined case after case, and find generally that the agreements declared void, where the power to vote was separated from the stockholder and invested in third persons, were, under circumstances which showed that the purpose to be accomplished was unlawful, such as the Court would not sanction if the principal had voted, and not a proxy; and in cases of a mere dry trust, it is held that the stockholder may revoke the power of attorney in

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[1] 5 Blatchf. 525. [2] 57 Ill. 416. [3] 98 Ala. 92.

form irrevocable. . . . If there were no precedents, upon principle we would hold that, in determining the validity of an agreement which provides for the vesting of the voting power in a person other than the stockholder, regard should be had to the condition of the parties, the purpose to be accomplished, the consideration of the undertaking, interests which have been surrendered, rights acquired, and the consequences to result. The law does not make contracts for parties, neither will it annul them, except to preserve its own majesty, and to serve the greater interests of the public."

This case admirably suggests the features by which all the cases holding agreements of this character void or revocable are to be distinguished. The test is, first, to determine if there is a sufficient consideration for the agreement, and, secondly, if the consideration itself is tainted with illegality. If there be no consideration at all, as is ordinarily the fact in cases of so-called naked or dry trusts, then it is like every other case of a promise without consideration, or of an offer not accepted. The agreement is not binding upon the promisor, and he may withdraw from it; not because it is against public policy, but because it is without consideration. So too, if the consideration be illegal, as it would be where holders of shares, representing in the aggregate a majority, agreed to control the election of directors, and through them the officers, for the purpose of parcelling out offices and salaries between themselves, or to enable one corporation to control another, or to obtain contracts from the corporation out of which the parties combining are to make a personal profit. The agreement is illegal only because the consideration is illegal. Instances of the case of a dry trust are to be found in Griffith *v.* Jewett, *supra*, and Vanderbilt *v.* Bennett,[1] and of corrupt consideration in Hafer *v.* N. Y. Co. and Gage *v.* Fisher, *supra*, Bostwick *v.* Chapman,[2] and Cone *v.* Russell.[3]

In White *v.* Thomas Co.,[4] where it was contended that a contract for pooling shares and giving the minority shareholders the power to elect a majority of electors was contrary to public policy and void, the Court said that the weakness of that contention lay in the fact that the voting trust was a part of the original contract between the original parties, and "was made for a proper purpose, and for a good consideration." The consideration was the advancement of cash by the promoters of the corporation, organized to exploit a patent, and the substance of the agreement was that

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[1] 2 Ry. & Cor. L. J. 409.

[2] 60 Conn. 553.

[3] 48 N. J. Eq. 208.

[4] 28 Atl. Rep. 75 (N. J.).

while these promoters should have the control of the management of the enterprise, the owner of the patent should have the majority of the profits. "So long as each retained his original interest, and no other rights intervened, I see no difficulty in holding such contract valid, and its enforcement proper and practicable. I see nothing in it contrary to public policy."

This reasoning, however, suggests another distinction sometimes referred to, which it seems difficult to support upon sound principles, where parties take with notice of the facts. It is difficult to understand how an agreement, valid at the outset between the parties and not violating any principle of public policy, can become invalid in that respect by any change in the ownership of the shares in question, or in the affairs of the corporation. So too, it is sometimes said in cases of pooling agreements, or generally, of agreements vesting the power to vote shares in others than the owners, that they are not void as against public policy, and are valid agreements so long as the parties to the agreement are content to abide by them, but are revocable at the pleasure of any party to the agreement. This is the adjunct to the doctrine that neither the State, nor the corporation, nor stockholders not parties to the agreement, can complain of it. In the words in which this doctrine is stated, it cannot be sound. If a valid agreement — that is, one made upon a sufficient consideration — is entered into between owners of shares, vesting in others the right to vote them, and the agreement is not void as against public policy, it is like any other agreement and cannot be abrogated without the consent of all the parties to it. Of course, where this arrangement does not take the shape of an agreement between shareholders and is nothing more than a concurrent act by which they severally vest in a naked trustee the right to vote the shares, and no consideration is paid by any one to secure this right to the trustee, the case would seem to be the ordinary one of an authority from a principal to an agent, not coupled with any interest, and therefore revocable at the pleasure of the principal. The principal has the right to revoke the authority, not because any principle of public policy is violated in permitting one who is not the owner of the shares to vote upon them, but because there is no principle by which the authority can be made out to be irrevocable. This was the case of Griffith *v.* Jewett, *supra*, where the action was not between different stockholders, brought to sustain an agreement as against each other, but a suit by the stockholder

against the trustee to restrain him from voting upon the complainant's shares; the Court saying: "There was no consideration moving from the trustees to the stockholders to support the agreement, and the trust is not coupled with any interest in the trustees." Where the trustee represents creditors as well as shareholders, as he did in Mobile & Ohio Co. *v.* Nicholas, *supra*, and Ervin *v.* Reading Co.,[1] this is said to be an active as distinguished from a dry or naked trust, and the power becomes irrevocable, except upon the consent of all concerned. In the latter case it was said: "On general principles the right to vote on stock cannot be separated from the ownership, in such sense that the elective franchise shall be in one man and the entire beneficial interest in another; nor to any extent, unless the circumstances take the case out of the general rule. It matters not that the end is beneficial and the motive good, because it is not always possible to ascertain objects and motives, and if such a severance were permissible, it might be abused." The circumstance that took that case out of the general rule was nothing more than the existence of a consideration. Again in Cone *v.* Russell, *supra*, it was said of the pooling or combining of stock that this is not forbidden where the object is to carry out a particular policy with a view to promote the best interests of all the stockholders; "the propriety of the object validates the means and must affirmatively appear." In the light of the facts of that case, these words mean nothing more than that the consideration for the pooling agreement shall not be unlawful. Another distinction is suggested by one of the cases. It is said that not only must the consideration for these agreements not be unlawful (that is, have any corrupt elements entering into the transaction) in the sense above pointed out, but that it must be valuable, and that the consideration is insufficient if it consists simply of promise for promise. This is one of many of the grounds of decision in Fisher *v.* Bush,[2] where the Court says: "Mutual promises alone do not constitute a good and sufficient consideration in contracts of this character. . . . It is essential to the validity of such agreements that there should be a special consideration paid to the promisor by the promisee." The soundness of this distinction is not apparent, but it has been seized upon by commentators as stating the law, and accepted without question.[3] It is difficult to perceive why an

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[1] 7 Ry. & Cor. L. J. 87.

[2] 35 Hun., 641.

[3] 28 Am. & Eng. Enc. of Law, 502.

agreement between two shareholders to vest in a third person, for a limited time and for no unlawful purpose, the right to vote their shares should be void as against public policy, while, if accompanied by some additional, substantial consideration, running to the owner of the shares, it would be valid; it being of course elementary that, as an ordinary principle of the law of contracts, mutual promises by themselves do constitute an adequate consideration, that is to say, sufficient to make the agreement binding.

It would seem, finally, that the State, as such, has no right to complain of these agreements for corporate voting; that they are no affair of the corporation itself, or of shareholders not party to the agreements. Neither the State nor the corporation, nor the other stockholders can or should control the transfer of ownership of shares, and therefore they should have no right to interfere with the transfer of some part of the interest owned, as, for instance, the right to vote upon the shares for a limited time. But if we eliminate the State and the corporation and the other stockholders, there is nothing left of the agreement to distinguish it from any other, or that should make its validity subject to any tests not applicable to every other agreement. I do not believe that any shareholder owes to his fellow shareholders any more of a duty to retain the right to vote upon his own shares, than he does to vote upon them at all, or not to sell, or not to sell them to any one unworthy; or that agreements given to others than the owners of shares the right to vote on them are illegal, except when their purposes are illegal; or that the control of the election of directors by itself is an illegal purpose. In the case of mere "dry trusts," that is to say, trusts not supported by any consideration, it may be that the stockholder should have the right at will to revoke the trust, but in the present state of corporation law I do not see why voting agreements should not be as valid as any other agreements, subject to only the same tests and entitled to the same respect and protection of the law. It has been well said by so distinguished a judge as Sir George Jessel: "It is the paramount policy not to interfere with the right of contract."

Jesse W. Lilienthal.

SAN FRANCISCO, 1897.